IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 384.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

MEREDITH WOOD,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

RALPH S. ROUNDS,
GEORGE M. WOLFSON,
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CITATIONS.

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BRIEF IN OPPOSITION TO PETITION.

Reference to the official reports of the opinions below and to the grounds upon which petitioner invokes the jurisdiction of this Court will be found in the petition (pp. 1, 2).

Statement of the Case.

Respondent, a resident of Scarsdale, New York, by declaration of trust, executed April 8, 1931, and amended by supplementary declaration of trust on March 25, 1932, created a trust expiring at the termination of a fixed period of five years, or the prior death of the respondent or his wife, with the income payable to respondent's wife during the existence of the trust, the principal of the trust at the

expiration thereof reverting to the respondent or his estate. The trust contained no powers of revocation (Rec., pp. 42 to 47).

The trust instrument, which was short, gave to the trustee (who was the respondent) certain formal powers usually found in trusts executed under the laws of New York. These powers were

> (a) To retain as a trust investment, or to sell, the Book-of-the Month Club Inc. stock originally constituting the corpus of the trust;
>
> (b) To make investments or reinvestments in so-called "non-legal" securities;
>
> (c) For purposes of the trust, to fix and determine the value of property held thereunder;
>
> (d) To determine whether properties or moneys received should be treated as capital or income and the method of allocating expense as between them, except that stock dividends and rights to subscribe to stock were to be treated as capital (Rec., pp. 42-43).

There were also provisions for substitution of trustee.

The trust expired on April 8, 1936 (Rec., p. 46). The income from the trust during 1934, the taxable year here in question, was received by the respondent as trustee, deposited in a special account, and was in its entirety turned over by him to the beneficiary. During the whole period of the trust the income was received and paid out in the same manner (Rec., pp. 24, 25).

The narrow question involved is whether such income should be taxable to the respondent instead of to the income beneficiary.

The Commissioner increased the respondent's income for 1934 by the amount of the dividends on the stock held in trust received during that year, and contended before the Board of Tax Appeals that such income was taxable to the respondent under Sections 166 and 167 of the Revenue Act of 1934 (Rec., p. 25). The Board of Tax Appeals held that such action of the Commissioner was erroneous (37 B. T. A. 1065). On appeal to the Circuit Court of Appeals for the Second Circuit, the Commissioner expressly abandoned his contention under Section 167 of the Revenue Act of 1934 and in his brief stated that the question presented was whether the taxpayer was "taxable under Section 166 of the Revenue Act of 1934 upon trust income paid to his wife as beneficiary" (Pet. br., C. C. A., p. 2). In his said brief petitioner further stated that "the Commissioner bases this appeal solely on the question whether or not such income is taxable under Section 166 of the 1934 Act" (Pet. br., C. C. A., p. 5). Said Section 166 of the Revenue Act of 1934 reads as follows:

> "SEC. 166. REVOCABLE TRUSTS.
>
> Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested:
>
> (1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

The Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals (104 F. (2d) 1013) upon the authority of *United States* v. *First National Bank of Birmingham*, 74 F. (2d) 360 (C. C. A. 5th).

The petitioner now urges in support of this petition a contention not previously made in the case, to wit: that the courts below erred in failing to hold that the income from the trust is taxable to respondent under Section 22 (a) of the Revenue Act of 1934 which defines "gross income" in general terms (Petition, pp. 5, 7).

Summary of Argument.

Respondent contended below and contends here that the reversionary interest of the respondent does not constitute a power to revest in the respondent title to any part of the corpus of the trust within the meaning of Section 166 of the Revenue Act of 1934; that neither in the trust instrument nor as a result of any rule of law did the settlor or any other person have a power of revocation or right to dispose of the corpus of the trust at any time during its existence; that to the extent that Article 166-1 of Regulations 86 as amended (Petition, Appendix, pp. 8 to 13) may be held to construe Section 166 of the Revenue Act otherwise, said regulation is invalid; that if Section 166 of the Revenue Act of 1934 were to be construed as taxing the income from this trust to the settlor, its constitutionality would be doubtful as taxing to one person income belonging to, and received by, another.

Respondent further contends that the income from the trust is not taxable to respondent under Section 22 (a) of the Revenue Act of 1934, and further that this point is not available to petitioner here, as it was not raised below.

ARGUMENT.

POINT I.

Respondent had no "power to revest" in himself "title to any part of the corpus of the trust".

Petitioner has confused a "power to revest" with an ordinary right of reversion.

Under New York law respondent had no right of revocation, or "revesting", since none was contained in the declaration of trust.

> *New York Personal Property Law*, Section 23;
> *Schoellkopf* v. *Marine Trust Co.*, 267 N. Y. 358, 361.

A reversionary interest can under no circumstances be construed as a power to revest. A power imports ability on the part of the possessor thereof to exercise an act of will. A reversion is a property right. During the existence of this trust respondent retained none of the incidents of ownership of the property. The well reasoned opinion of the Board of Tax Appeals herein, as affirmed by the Circuit Court of Appeals, finds ample support in numerous decisions of lower courts.

> *United States* v. *First National Bank of Birmingham*, 74 F. (2d) 360 (C. C. A., 5th);
> *Shanley* v. *Bowers*, 81 F. (2d) 13 (C. C. A., 2nd);
> *Clifford* v. *Helvering*, 105 F. (2d) 586 (C. C. A., 8th);
> *Knapp* v. *Hoey*, 104 F. (2d) 99 (C. C. A., 2nd);

Downs v. *Commissioner*, 36 B. T. A. 1129;
Rovensky v. *Commissioner*, 37 B. T. A. 702;
Hormell v. *Commissioner*, 39 B. T. A., No. 37.

Although the precise question would appear not to have been decided by this Court, it is submitted that the question is neither difficult nor important nor in conflict with any applicable decisions of this Court, nor has there been any conflict between the circuits with regard thereto.

Petitioner places some emphasis upon the right of the trustee (who was, during the continuance of the trust, respondent) to determine whether property or money received from the trust should be treated as capital or income. But this is a customary provision in New York trusts, as are the other formal provisions above quoted. Any one familiar with the difficulty which the New York Court of Appeals has had in dealing with the problem of allocating extraordinary dividends and unusual distributions as between principal and income will understand why draftsmen of New York trusts customarily attempt to obviate this fruitful source of litigation. (See *Matter of Osborne*, 209 N. Y. 450; *Equitable Trust Co.* v. *Prentice*, 250 N. Y. 1.) It should be further noted that a retention of any actual income in principal account would violate the New York statute regarding accumulations (N. Y. Pers. Prop. L., sec. 16). The fact is, as above stated, that all income was paid to the beneficiary.

The petition in the *Clifford* case (No. 383), which is incorporated by reference in this proceeding (Petition, p. 5), places a good deal of reliance upon *DuPont* v. *Commissioner*, 289 U. S. 685 (Petition, *Clifford* case, p. 7), where this Court was considering the constitutionality of a provision in the Revenue Act of 1924 which provided that

premiums for insurance on the life of the grantor, that part of the income of the trust should be included in the grantor's income for tax purposes, and held said statute to be constitutional. It should be noted, however, that in the companion case of *Burnet* v. *Wells*, 289 U. S. 670, Mr. Justice Cardozo was careful to distinguish life insurance premium trusts from trusts such as that in the instant case, stating at pages 681-682:

> "Trusts for the preservation of policies of insurance involve a continuing exercise by the settlor of a power to direct the application of the income along predetermined channels. In this they are to be distinguished from trusts where the income of a fund, though payable to wife or kin, may be expended by the beneficiaries without restraint, may be given away or squandered, the founder of the trust doing nothing to impose his will upon the use."

The mere statement of petitioner's argument that a reversion is the same as a "power to revest" during the continuance of the trust would seem to bear its own refutation.

POINT II.

To the extent that Article 166-1 of Regulations 86 as amended by T. D. 4629, requires the taxation of the income from this trust as income of respondent, the said Article is invalid.

The Treasury regulation relied on by petitioner (Petition, pp. 8 to 13) obviously goes far beyond the language of Section 166. The petitioner contends that since the Revenue Acts of 1936 and 1938 are similar to the Revenue Act

of 1934, this regulation has ripened into legislative fiat (Petition, *Clifford* case, p. 7). But this argument is without substance. The legislative power is vested solely in the Congress, and this Court has held that treasury regulations cannot go beyond the taxing statute.

Koshland v. *Helvering*, 298 U. S. 441, 445;
Blatt Co. v. *United States*, 305 U. S. 267, 279.

There is no ambiguity in the meaning of Section 166, which requires clarification by Treasury decision.

Nor is there anything in Section 22 (a) of the Revenue Act of 1934 which would justify the provisions of Treasury Regulations 86 relied on by petitioner, but in any case petitioner will not be heard to urge the point at this stage of the litigation, not having raised the point below.

Blair v. *Oesterlein Co.*, 275 U. S. 220, 225;
Van Huffel v. *Harkelrode*, 284 U. S. 225, 229;
Burnet v. *Commonwealth Imp. Co.*, 287 U. S. 415, 418.

POINT III.

If Section 166 (or any other provision of the 1934 Act) had the effect of taxing income from this trust to respondent, its constitutionality would be doubtful.

Respondent submits that Section 166 cannot, except by the most strained construction of language, be construed so as to render the income from this trust taxable to respondent.

Respondent further submits that were the statute to be construed as desired by petitioner, its constitutionality

would be seriously imperilled. Congress has no authority to tax to one person the income of another.

Blair v. *Commissioner*, 300 U. S. 5;
Hoeper v. *Tax Commission of Wisconsin*, 284 U. S. 206, 215.

"That which is not in fact the taxpayer's income cannot be made such by calling it income."

Conclusion.

The petition for writ of certiorari should be denied.

Respectfully submitted,

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GEORGE M. WOLFSON,
Attorneys for Respondent.

October, 1939.